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Economic Conditions
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General Business Conditions

THE commodity and security markets have quieted down during August, as compared with late June and July. However, sentiment was well prepared for the slackening, since the rise had been greater than expected; and the better feeling which spread over business while the markets were advancing has not been seriously disturbed. Buyers of industrial materials have stepped back to the sidelines not because they have suddenly turned pessimists, but because their purchases in June and July covered requirements for some time ahead. The slowing down is welcome, for the speculative markets were moving faster than business improvement could possibly go; and if pushed too far there would be danger of a demoralizing reaction.

In the merchandise markets activity has not been as brisk as manufacturers would like. Retail buyers are inclined to see how Fall business starts before committing themselves heavily. But merchants are reasonably optimistic, and in most manufacturing lines the feeling is that sales will improve as the season progresses. It is the usual thing, when there is no special inducement to buy ahead, for business in finished goods to expand more slowly than demand for raw materials, which is subject to wider fluctuations.

Compared with two or three months back the industrial situation has been strengthened substantially. The spurt in the markets gave the metal and textile industries, in particular, more orders to work on, reduced their unsold stocks, and enabled them to raise operations to the best rate in many months. These are the most conspicuous gains, but other industries also have begun to move forward moderately, and the tendency of improvement to spread from one area to another brightens the outlook for all.

The Federal Reserve index of industrial production made a sharp advance in July to 83 compared with 77 in June and 76 in May, the low. According to preliminary data the index is likely to show another, though smaller, rise in August. This improvement tends to confirm the favorable indications given earlier by the markets. Probably a good many business men are waiting for September to give further confirmation. If this month brings good reports, in the shape of satisfactory retail trade, a good reception of new automobile models, and reasonably firm and active markets, it is safe to say that the prospect for further recovery in the Fall and Winter will be viewed everywhere with confidence.

The Decline in Farm Prices

Prices of farm products have been weak during the month, and this weakness has naturally led to expressions of concern as to the prospective farm buying power. Prices of wheat and corn are only about half what they were a year ago and cotton, livestock and other products are substantially lower also. Despite larger crops and livestock marketings, farm income will be less than it was last Fall. According to estimates by the Department of Agriculture, farm cash income during the last five months of the year will probably be about \$3½ billions against \$4 billions in the same period of 1937, a decline of 12½ per cent.

No one can afford to be complacent about the level of farm prices. Judged by the relationships that have existed in past times of prosperity, they are too low compared with prices of most manufactured goods, and the disparity is a drag on recovery. There is little reason to fear, however, that a business upswing originating in the industries, and starting from the present low level, will be stopped by the farm situation. Each dollar of farm income will buy more than it would a year ago. Factory employment is rising, and industrial workers will be able to buy more farm products and pay more for them. The Department of Agriculture has repeatedly shown that farm income tends broadly to rise as industrial production rises, and vice versa. Attention should be paid to the benefits of big crops to the railroads, the handlers and processors, and the consumers, whose income will go farther at the lower prices. Experienced merchants in

the farm States, in judging the trade prospect, stress the advantage of good yields, which is recognition of the fact that large yields reduce unit costs, and yields this year are exceptional.

Moreover, the drop in farm income is not a new factor in the business situation. The decline above estimated is about the same as the decrease during the first seven months of the year. Thus business has already been feeling the effects of smaller farm income for a considerable period. If business were approaching the peak of a boom, or were otherwise losing momentum, a drop of this extent in farm prices and income might be a disaster; but the present situation is more nearly the reverse.

Prices of industrial materials are more significant as indicators of business trends than prices of food and feedstuffs. Although markets for these materials have been slack, as already stated, prices have held steady, with the metals, rubber, hides and wool standing at or close to the peak of the recovery. Latest figures show a good statistical basis for the price advances. In almost all cases deliveries have finally begun to exceed production and the trend of visible supplies is downward, for the first time since the beginning of the depression. When stocks are declining commodity markets normally are strong, even though supplies are still ample.

Further Gains in Industries

Among industrial reports in August, the continuing uptrend in steel mill operations, from 37 per cent of capacity in the last week of July to 43 at the end of August, is the most favorable. The rise, which is more than seasonal, establishes operations at the highest rate since last November, and without much help in the way of advance buying from the automobile manufacturers. Most steel companies look for a further rise when more automobile orders come in and projects requiring heavy steel get to the award stage. The chief gain so far has been in demand from the miscellaneous industries whose takings of sheets, strip and other light steel have become so important in recent years. They are replenishing their depleted stocks, and many see the start of improvement in their own business.

The automobile manufacturers, like retail merchants, are disposed to move carefully until they test the market with 1939 models. However, the automobile situation has improved. Retail sales in July and August, normally a period of decline, have slackened less than expected. The effect is to bring a quicker cleanup of dealers' stocks, both new and used cars, than was formerly looked for. August will be the low month in assemblies, with a gradual pickup in September, and most of the industry will be under way again by early October. With dealers' stocks down, early sales of new models are likely to be satisfactory and the industry is taking a more cheerful view of its next season's prospects.

Improvement in machine tool orders in July, when they were 28 per cent over June, and in August is an encouraging development. The capital goods industries are not expected to contribute much to business recovery, during this Fall at least, and a better showing in any particular is heartening.

Residential Building Up

Building figures also are more encouraging. In May residential contract awards were practically equal, for the first time, to the same month a year earlier; and in June, July and early August they have run substantially ahead. Undoubtedly the effort to reduce the cost of home construction and financing, so that more people of lower income classes could become home owners, has been more successful than its critics were prepared to believe. The bulk of the new construction is in this class. According to the last report of the Federal Housing Administration more than two-thirds of all homes financed through insured mortgages had house and lot valuations ranging from $3,000 to under $7,000, and about half of the borrowers had incomes of under $2,500 annually.

The mortgage insurance activities of the F.H.A. are holding at about the same rate as in the Spring, which is the normal peak season. This is an indication that residential building will make a strong showing through the Fall. Private non-residential construction is on a low level, and publicly-owned building in July fell behind a year ago, after running ahead during the first six months. The building material industries are taking a fairly hopeful view of the Fall, in the belief that the residential improvement will hold and public construction increase, while their own surplus inventories have been largely worked off.

The textile industries have supplied little noteworthy news. Markets have been dull for the most part, and cotton goods prices weakened again early in the month; but the improvement in the mill position as a result of the earlier buying has sustained operations. Cotton consumption in July increased 8 per cent over June, on a daily average basis. The rayon industry had an exceptional month in July, when yarn deliveries broke all records, and turnover in the fabric markets has picked up substantially. Wool mill operations also improved. Expectations that the Spring woolen season now opening will be better are apparently well-grounded. Furniture business has expanded and prices have been raised on the low-end lines. Reports from the shoe industry have improved. The tire industry is clearly in shape to do better, with inventories everywhere cut down and a new season on original equipment tires starting.

Department store sales during August have run about 12 per cent behind last year, as they did during July. Making allowance for seasonal changes, the low point of department store trade was in May; June and July were both better months and August has about held its own, except where excessive heat and rain have interfered. Mail order sales are showing a decreasing percentage of decline from the same month last year.

Recovery Is Cumulative

In considering the influences that are likely to affect Fall business, the fact that general productive activity has turned upward, as shown by the foregoing summary, is evidently the most important. The improvement has gone far enough to indicate that the turn is real, but not far enough to run into a natural setback. Evidently the turn came because excess stocks of goods were to a considerable extent absorbed, production had fallen substantially below consumption, and the need for greater production asserted itself. It is unlikely, judging by all past experience, that the impetus is exhausted, and of course the deficit expenditures of the Federal government, supporting consumer income, will enable a good many people to satisfy their needs who otherwise would not be giving much help to trade.

At any turn from depression into recovery the obstacles which prevented the pessimists from foreseeing the rise are still prominent, but it is the nature of recovery to make headway against handicaps, and some of the obstacles tend to disappear as the volume of business improves. Situations which are a cause of worry during depression, and which restrain confidence and enterprise, are helped more effectively by business revival than by any other support that could be given them. The financial position of a number of the railroads in this country has caused general anxiety, and in several cases still does; but it is certain that nothing can do as much for the railroads as an increase in their traffic, which comes only from a trade revival. With big crops to move, and the prospect of a heavier freight movement, the railroad outlook is obviously less gloomy than it appeared a few months ago, and this means that investors and business men who were oppressed by it can go ahead with more confidence.

Moreover, a rise in business volume tends to improve price relations, and to restore the balance in the economic system in other ways. The tendency is for prices of crude and semimanufactured materials to rise while finished goods prices stay about where they are, and this raises incomes of raw material producers and starts a flow of new buying power around the circle. During every depression business men reduce their costs; and when they can once more step up production the benefits of the gains in economy and efficiency are disclosed. Unit costs decrease as volume rises, and profits reappear. In truth, recovery and restoration of a better economic equilibrium go along inseparably together. The effect of increasing volume in improving price, cost and profit relationships is one of the reasons why the upswing is cumulative in character.

Questions for the Future

Finally, the situation supplies considerable assurance that the analysts who predicted a relatively short life for the depression were correct in their reasoning. The essence of the argument was that there was no great body of debt that would be liquidated, and that much of the deflation, distress and disorder which followed after 1929 would thereby be averted. Accepting this assumption, the drastic character of the production curtailment indicated that the depression, while severe, would not be greatly prolonged.

Those who ascribed the depression to the change in Federal Reserve policy in 1937, and to the turn from a Treasury cash deficit to a cash surplus in the second half of that year, can of course point to a complete reversal of both policies. The Treasury is running a great deficit again and bank reserves and deposits have been built up once more, almost to new highs.

On the other hand, no one can maintain that other conditions which contributed to the depression have been reversed. The increases in taxes and wage rates which raised industrial costs and disturbed price relationships are still generally in effect. The capital markets have been reopened to the highest grade borrowers, but not to new enterprises, and the bulk of the offerings represent refunding rather than the investment of new money.

A recovery is under way and it can be expected to continue until pressing needs are as far as possible satisfied. Whether the rise will go farther or last longer will depend upon two factors. The first is the ability of the industries to keep costs and prices down to levels which consumers can pay. Undoubtedly they should give consideration to the reduced farm income already noted, and to the uncertain prospects for an improvement in the farm position. The industries and farms trade goods with each other, and if the trade is to go on successfully it must be conducted upon practicable terms.

The second consideration is that no section of business can prosper long unless others prosper. When the momentum of the first rise slackens the urgent question will be whether the improvement will extend into the machinery, rail and utility equipment, heavy construction and other capital goods industries. The necessary condition is that entrepreneurs, and investors who might finance them, have the incentive to take risks.

Foreign Affairs

It cannot be said that the state of the world is more assuring than it was a month ago. In Spain the plan for narrowing the war to Spanish combatants by a withdrawal of foreign forces seems to have fallen through. In Czechoslovakia the situation remains strained, although every month that passes encourages hope that the peace will not be broken. Between Japan and Russia the situation is less alarming, but in China the tragedy goes on.

Three months ago we described again the perplexities that have baffled the premiers and ministries of France over the last ten years. The sum of these difficulties may be stated for governments, as for families, in the homely phrase, "inability to make ends meet." In the June number we described the inauguration of a new Premier, M. Daladier, who like his predecessor M. Chautemps has made a sturdy struggle against disheartening conditions. M. Blum, predecessor of M. Chautemps, had devalued the currency to restore prosperity, relieve unemployment and increase wages, but had been voted out by the Parliament. Premier Chautemps came in with the currency already below the Blum 1936 level, and he tried for nearly a year to establish it firmly on even a lower basis. When he was forced to give up, last March, M. Blum had another brief lease of power, but was quickly followed by M. Daladier. In his opening address to the Chamber of Deputies the latter talked plainly. Following is a sample:

> The basic idea of the plan is to stimulate French production. In practically all departments French output is substantially lower than that of most European Powers. The necessary equilibrium can be achieved only through work. And the plan must, therefore, remove all obstacles to an indispensable increase in production, without which there can be no recovery.

In order to gain a new footing M. Daladier agreed that the currency must be again devalued. He said:

> A solid starting base is necessary for any policy of lasting confidence. It is essential, first of all, to fix a monetary level that corresponds to our charges and that is not always put in question, and that places the franc secure from any repetition of the attacks to which it has been subjected during recent years.
>
> That is why, without concern for criticism, I have decided to carry out a retreat of our money and to stabilize it on a basis where it can be effectively defended.

The new franc was tentatively valued at the equivalent of 27.60 milligrams of gold, which compares with 43 milligrams for the Chautemps franc and 49 for the Blum franc. The Daladier franc has a nominal value of 2.79 cents in present money of the United States, but has sold within the last month as low as 2.72½ cents.

M. Daladier is making a courageous fight, and lays the blame for this break to the 40-hour week, established by law under the Blum regime. He says this is restricting the power of the French people to provide for their own wants or their own protection against menacing dangers. In an address last month he is quoted as referring to the tripartite agreement in which the United States and Great Britain are allied with France in a pact for the stabilization of currencies. The press report follows:

> The defense of the country, he declared, meant not merely its defense by arms but also in its factories, its currency and its finances. It was necessary in the financial field to avoid any crisis lest it lose for France the valuable friendships of Great Britain and the United States. Such a crisis, he said, was possible, because of the great falling off of national income due to decreased production. He said:
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> "I am certain that a new devaluation of the franc or the establishing of exchange control would lead immediately to the collapse of the international collaboration that I have just mentioned. And I am equally certain that a monetary and financial crisis would be considered a favorable circumstance by those who want war."
>
> "The road to safety is work. The forty-hour week must be changed as much because of national necessity as because of the general European situation."

The party with which the Premier is identified, known as "Radical-Socialist", (although in sentiment it is only moderately socialist), apparently is supporting him in this demand. The Parliament adjourned in July, and may be called in extra session for action on this subject.

Money and Banking

An upward trend in loans to business has been the most noteworthy development in the banking reports during August. The rise is small, but in conjunction with better business reports and the usual seasonal requirements for banking accommodation, it presumably marks a turn in the downward trend of business loans, which has run since last October. From that time to the end of July the drop in the commercial, industrial and agricultural loans of the weekly reporting member banks was slightly more than a billion dollars. With the rise in investments during July, due to subscriptions to the R.F.C. issue, and a moderate increase in brokers' loans, total credit outstanding has increased over the July low point by around $200,000,000.

Bank holdings of Government securities changed very little in the early part of the month, although the Treasury raised $50,000,000 of new money each week through issues of 91-day bills. Substantial subscriptions to these issues were made by corporations. In the week ended the 24th, however, holdings of Government securities by the reporting banks increased $50,000,000, most of the rise occurring in New York City.

The volume of excess reserves held by the banks has fluctuated irregularly during the month, affected chiefly by the varying rate of Treasury receipts and disbursements. Early in the month the Treasury was absorbing funds, due to the weekly bill issue, quarterly

security tax payments, and substantial receipts from capital stock and other taxes; and excess reserves were reduced from the recent high of $3,150,000,000 to $2,920,000,000. Subsequently Treasury disbursements again exceeded receipts and reserves rose moderately.

During September a temporary reduction in reserves is to be expected, due first to the increase in circulation over Labor Day, and second to income tax payments and subscriptions to the Treasury security offering expected on September 15. With the large excess of funds on hand, banks subscribing to the new issue will naturally pay in cash for the most part, rather than by entering a deposit to the credit of the Government. Treasury balances, already unusually large, will thus reach extremely high figures after the 15th. Eventually, of course, these funds will be returned to the market through Treasury disbursements, and excess reserves will mount again. Gold imports likewise will tend to raise reserves, while a factor reducing them will be the seasonal expansion in circulation, especially toward the end of the year.

With the cushion of idle bank funds so large, no early or material change in the money markets is generally expected. The Treasury bill rate during the month has held below 0.05 per cent. While waiting the announcement on Treasury financing, prices of Government, municipal and high grade corporate bonds have remained steady. Lower grade bonds, influenced primarily by the course of business activity and earnings, developed some irregularity, following their sharp advance earlier.

New security offerings during August were larger than those in July, and the total for the month was one of the highest in more than a year. The flotations were in general highly successful, many of the issues promptly commanding substantial premiums above the offering price. Following are the more important new issues and the prices at which offered:

Principal New Offerings During August

Commonwealth Edison Co. 1st 3½s of 1968 @ 103½	$33,000,000
Commonwealth Edison Co. conv. deb. 3½s of 1958 @ 100*	39,250,000
Crucible Steel Co. s.f. deb. 4½s of 1948 @ 99¼	10,000,000
Gulf States Util. Co. 1st & ref. 4s of 1966	10,000,000
Indianapolis Pr. & Lt. Co. 1st 3¾s of 1968 @ 100	32,000,000
Lone Star Gas Corp. s.f. deb. 3½s of 1953 @ 102	20,000,000
New York Steam Corp. 1st 3½s of 1963 @ 100	27,982,000
Phillips Petroleum Co. conv. deb. 3s of 1948 @ 100*	25,000,000
Public Ser. E. & G. Co. 1st & ref. 3¼s of 1968 @ 104¾	10,000,000
Toledo Edison Co. 1st 3½s of 1968 @ 101½	30,000,000
Toledo Edison s.f. deb. 4s of 1948 @ 100¾	6,500,000

*First offered to shareholders.

Of the $243,732,000 corporate financing listed above, only about $32,500,000 was for raising new capital, the balance being for refunding purposes. Numerous registration statements that have been filed for future issues, or that are in prospect, point to an active financing season this Fall, in contrast with a year ago, when the volume of new offerings declined to a low level.

Gold and the Pound Sterling

The London gold and exchange market has provided the most important financial news of late. In the closing days of July and first half of August a rush of buying of dollars and gold swept over it, accompanied by a decline in the pound sterling as against the dollar. In its intensity the demand for gold exceeded any of the waves of hoarding which have risen and receded since 1931. In the three weeks ended August 18 about $120,000,000 gold was officially bought and sold, and the price rose to 142 s. 8 d. per ounce, which compares with the pre-1931 par of 84-15/16 shillings. Subsequent shipments to the United States show that much of the gold was taken for American account, representing a transfer of funds from sterling into dollars.

The Exchange Equalization Account, which ordinarily is expected to supply gold when the stream of newly-mined metal fails to meet demands, on several occasions refused to sell, apparently believing that it would be better to allow prices of gold and sterling to take their natural course. The stated policy of the Fund is not to peg prices, but to iron out fluctuations to maintain an orderly market. However, this action temporarily intensified the demand. The premium on gold coin went up to 6 per cent, indicating that gold was sought even by those who were unable to raise the $14,000 necessary to buy a bar of the metal. Demand for coins of course reflects hoarding.

The demand for gold, particularly coin, also spread to other centers, as Paris, Brussels, and Amsterdam. In India, demand for gold sovereigns for some time has been so strong that it has lifted bullion quotations in Bombay above London. This indicates that India may begin to absorb gold again, after seven years of paying it out, during which more than $1,250,000,000 was sold from private holdings.

As a result of the hoarding purchases, it may be surmised that private holdings of gold in London again exceed $1,000,000,000. At the end of September, 1937, they were estimated at less than $500,000,000. During this ten and one-half month period, London has retained about $450,000,000 of imported gold, on balance, but none of this has appeared in Bank of England reserves. The Equalization Account secured about $93,000,000 during the six month period September, 1937 - March, 1938, bringing its holdings to $1,487,000,000 according to the last semi-annual statement. Since then the Account is reported to have lost several hundred million dollars in supporting operations.

Heavy absorption of gold in private hoards is apparent from the trend of gold reserves in 52 countries, as reported by the Federal Reserve Board. At about $23,800,000,000 at the end of June, 1938, the aggregate reserves were hardly $100,000,000 greater than at the end of September, 1937, although the world output outside of Russia, together with the shipments of Soviet gold to London, aggregated nearly $900,000,000 during the same nine months. A portion of this "disappeared" gold may have gone into undisclosed reserves of Germany and other countries, or into the stabilization funds of France, Switzerland or The Netherlands.

Impounding of "Hot Money" in Gold

The demand for gold in London is a sequence to the flow of liquid capital to that center from all over the world. Since last Fall, when the business recession here became pronounced, even the United States has lost funds to London, and the movement has been promoted by "dollar scares" with rumors of further devaluation, which, although unwarranted, prompted movements of funds. The outflow of foreign banking funds from the United States between September 29, 1937 and March 30, 1938, according to Treasury figures on capital transactions, amounted to $794,000,000 (reducing the totals from $1,744,000,000 to $950,000,000). London received far more than any other center.

This movement kept the pound from falling below $4.94 up to June, when the latest of the "dollar scares" took place. Since the early part of July the flow of capital has turned this way, and large shipments of gold to New York have been made. London, however, has continued to be the haven of nervous capital from the Continent. The tension and disorder in European affairs, political and economic, account for conversion of funds into dollars and gold.

As rumors spread that the pound sterling would be revalued at the traditional parity with the dollar, the pound sterling declined to $4.87⅛ on August 13, the lowest level since May, 1935.

Factors in Weakness of the Pound

Although the movement of funds into gold or dollars has been the direct cause of the readjustment of the pound, and the tendency of masses of people to do the same thing at the the same time is one of the elements, there are other conditions which have contributed to the decline, and have influenced the Exchange Equalization Account to allow it. Most serious has been the influence of the mounting excess of British imports, which rose to £235,400,000 during the first seven months of this year, from £222,100,000 in the same period last year and £139,100,000 in 1933. Imports have declined more slowly than exports, because of the British rearmament program. Likewise, income from investments and shipping has declined.

Moreover, the pound sterling has been under the adverse influence of declining trade and more unfavorable exchange balances for the countries of the sterling bloc. These countries keep reserves in London. As the London Economist points out, "sterling will also depreciate in terms of dollars, if for example Australia is drawing on her London funds to meet an adverse balance, just as surely as if the deficit had originated in Great Britain".

Since last Autumn the decline of commodity prices and the contraction of world trade have impaired the purchasing power and paying ability of most of the primary-producing countries. This will be seen from the following table. The Dominions, India, Egypt, Sweden and Argentina, all of the "sterling bloc", had a combined export surplus of only $115,000,000 in the first half of this year, against $783,000,000 a year earlier.

Merchandise Trade Balances, 1934-June 1938
(000,000 Dollars)

Date	United States	United Kingdom	Sterling Bloc*	Japanese Empire (Yen Area)
1934	+466	—1,448	+566	— 74
1935	+202	—1,354	+613	— 45
1936	— 5	—1,723	+939	— 46
1937	+285	—2,140	+928	—246
6 Mo.				
1937	—113†	—1,087†	+783	—216
1938	+704†	—1,156†	+115	—113

*India, Australia, New Zealand, Canada, South Africa, Egypt, Sweden, Argentina. †7 months.

The next table shows the effect of the lag which normally develops between the exports and imports. Since imports have not yet contracted as much as exports, the foreign exchange reserves of the primary producing countries, which were accumulated during the period of high prices and heavy exports in 1936 and 1937, have been heavily drawn upon in payment for imported merchandise.

Gold & Foreign Exchange Reserves
(Millions of National Currency)

		June, 1937 Gold	June, 1937 For. Ex.	June, 1938 Gold	June, 1938 For. Ex.
Australia	(A. £)	16.0	38.6	16.0*	24.2*
New Zealand	(N.Z. £)	2.8	21.5	2.8*	15.1*
India	(rupee)	444	228	444*	35*
Egypt	(E. £)	6.5	25.3	6.5	22.9
Yugoslavia	(dinar)	1,678	880	1,834	446
Roumania	(lei)	15,863	5,875	16,872	4,620
Argentina	(peso)	1,224	334	1,313	31

*July.

The Strength of the Dollar

In sharp contrast with the pound sterling, the dollar has continued to grow stronger. This strength is due fundamentally to our extremely favorable balance of merchandise trade. Between September, 1937, and July, 1938, United States exports exceeded imports by $1,020,000,000. This trade balance substantially exceeded the total of capital with-

drawals already referred to, and as soon as the outflow of foreign funds began to taper off as a result of the improved outlook for business and the rise of the stock market, the strength of the dollar became apparent.

Net imports of gold into the United States this year through August 29th, aggregated $425,000,000. Gold reserves on August 24 were $13,079,000,000. In contrast, the disclosed reserves of 51 foreign central banks and governments outside Russia together were about $2,100,000,000 less than ours, or approximately $10,900,000,000. The United States holds, therefore, 55 per cent of the world's known gold reserves, a larger share than ever before.

In further contrast with the pound, demand for dollars is likely to persist in the future, and more gold will have to be received. However, our present favorable trade balance may be reduced. Larger imports of industrial raw materials should follow any improvement in business, and exports to primary producing countries may be curtailed further, as their reserves of foreign exchange dwindle.

In some of the primary-producing countries, for example Argentina, imports have been sharply curtailed in recent months, resulting in a slight firming of their respective currencies. In order to recover a better exchange position some of the Latin American countries have let the "free" exchange rates find their own level, or have restricted the official permits. This has discouraged imports, and made debt services more costly.

Japan's Gold Exports

Japan has been one of the most important sources of our gold imports, sending us about $120,000,000 since the first of this year. At the end of July $100,000,000 from the Bank of Japan's reserves was allocated for export, to establish a revolving foreign exchange fund. Since Japan had exported $246,000,000 to this country in 1937, a sum nearly equal to the entire gold reserve of the Bank of Japan at the beginning of 1937 ($463,000,000) has been shipped abroad or marked for shipment. In the meantime, however, the Bank of Japan has replenished its reserves by the purchases of secondary gold at home and of new production. It had about $163,000,000 (500,000,000 yen) at the beginning of August, as reserve against its outstanding currency notes.

World Output of Gold Continues to Expand

The drop in the world level of commodity prices during the past year, and higher sterling prices of gold, tend to widen profit margins for gold mining operations. New gold mines are being opened as a result of capital investments prompted by the depreciation of currencies in 1933-35.

In the Philippine Islands six new mines have opened since the first of this year, bringing the total to 29. The output for the first six months rose nearly 25 per cent above the similar period last year. Japan has invested several hundred million yen in the exploitation of gold deposits in Korea and Manchukuo and hopes to double the production within two years. In Canada some 30 new mills will come into operation during 1938, increasing the existing capacity by more than 11 per cent. In Africa, mechanical appliances are more widely used to overcome the chronic shortage of native labor in the Rand gold-mining industry, which is unable to utilize fully its milling capacity. New high records in volume and value of the gold output are being established each year.

The rate of increase gradually has slowed down as the effects of currency revaluations have worn off and costs have increased. The 1938 world output of gold outside of the Soviet Union may be expected to reach $1,100,000,000, as against $1,045,000,000 mined in 1937, and a total production in 1913 of $(old) 434,000,000.

It should be understood that the apparent instability of gold, as seen in the fluctuations of currencies in their relations to gold, is not in gold, but in the changing conditions of the currencies themselves, and in the state of trade of the several countries. Gold is prized and hoarded as much as ever, and the paper currencies are rated to each other through their relations to gold. Gold is practically the only medium by which large sums of capital may be readily transferred from one country to another. The disorder in world trade today is chiefly caused by the instability of so many currencies in relation to gold. The international gold standard was not broken down by the demands of normal industry and trade, but by the war and the menace of war indebtedness.

The Problems of the South

Two months or more ago the National Emergency Council called a conference of citizens of the Southern States, to meet in Washington, D. C. on July 5, to consider the economic problems of the South. The Director of the Council laid a "tentative statement" of the problems before the Conference and gave copies to the President and the press. Twenty-three leading citizens were reported as present. Upon the President's return from his Pacific trip the complete statement, extended to 16 columns, was given to the press. It is an elaborate paper, and worthy of attention.

As we can give only limited space to the paper itself, we quote the first three paragraphs of the July 5 statement, as affording a better condensation than we would be able to make. These read as follows:

ECONOMIC RESOURCES — With respect to its physical resources, the South has been richly endowed. No other region of the country offers such diversity of climate, soil and topography. With this wealth of population and natural resources, however, the South

is poor in the machinery of converting its potentialities into riches.

With 28 per cent of the nation's people, it has only 16 per cent of the tools with which people make their living; with over half the country's farmers, the South has less than one-fifth of the nation's farm implements.

The paradox of the nation is that the South, which is one of our wealthiest sections, is at the same time the poorest. It is wealthy in natural resources and advantages, and poor in ownership and control of the money and credit necessary for their development and exchange. As a result it must sit by and watch its plenty enjoyed by other sections not so abundantly blessed by nature but in control of the man-made machinery of finance.

As a literary production the paper is exceptionally well done, and it backs up its claims regarding natural wealth and the fecundity of soil, climate and population with facts that are incontrovertible. After making a presentation of these which is overwhelming in detail, it virtually says that the half has not been told, inasmuch as the report is not so much concerned with what the South has as with what it needs. The result is a picture of human distress and helplessness in the midst of abundant resources that is very depressing, and we venture to believe, essentially erroneous, and prejudicial to the South.

This, of course, is not to say that poverty and certain deplorable conditions do not exist in the South, for they exist everywhere; but that we believe the scene, as a whole, to be overdrawn and not true to actual conditions. The people of the South, as a whole, are not, and never have been, a group of incompetents.

The English colonies in America, South and North, started under much the same conditions. They were not endowed with anything but land that belonged to Indian tribes, and, as to that, any one who has seen a New England corn field will agree that the Southern settlements fared best. There were assisted immigrants, or "indentured servants," in all the groups, who had contracted to serve for terms of years to pay their passage to America; but that only illustrates the state of the working people of all Europe at that time. All of the colonies were on their own resources; they had to find a living in the wilderness. It was literally "root, hog, or die," but in both North and South they established permanent states. Moreover, the South made its full contribution to the establishment of the United States of America. A Southerner wrote the immortal Declaration of Independence, and of the first seven Presidents, five were from the South, of whom four were from Virginia, and the other two were from one Massachusetts family.

Handicaps of the South

Economic conditions shape economic development. New England had no crops like tobacco and cotton, with which to trade; hence took to the sea. The small island of Nantucket built up the greatest whaling fleet in the world, and accumulated wealth with it until kerosene oil put the whalers out of business. The New England clipper ships traded from port to port around the world and brought the finery of the Orient to adorn the fine ladies of the South. New England had no mineral wealth, and for that matter, the mineral wealth of the South was scarcely touched until after the civil war. That war makes a sad chapter in American history, and was economically disastrous to the South. These states were compelled to begin a new order, economically and otherwise, under inevitable handicaps. This report shows that the population of the old South is nearly all of American ancestry. That region has had little of the fructifying streams of immigration which helped to build up the North and West. In the years from 1861 to 1914 nearly 25,000,000 immigrants came to the United States, most of whom became useful citizens, and many of whom brought some capital. Only a few of these immigrants went to the South. They were looking either for jobs or land, and most of them were guided by friends already here, either in the industrial centers of the North, where wages were relatively high, or out on the prairies where farms were readily opened.

Of course, the signers of this Report are informed as to this, for they have witnessed the same influence at home. One of the statements of the Report is as follows:

In the Nineteen Twenties the States south of the Potomac and Ohio rivers and east of the Mississippi lost about 1,700,000 persons through migration, about half of whom were between 15 and 35 years of age. These persons moved at the beginning of their productive life to regions which got this manpower almost free of cost, whereas the South, which had borne the expense of their care and education up to the time they could start producing, suffered an almost complete loss of its investment. The newcomers to the South did not, by any means, balance this loss. The cost of rearing and schooling the young people of the Southern rural districts who moved to the cities has been estimated to be approximately $250,000,000 annually.

While this migration from the South was going on, young people were moving from the Eastern and Middle states, and Canada, to the West and Southwest also. Canada was fostering immigration from the mother country, but in most of the years after 1880 was losing population to the United States. People go where they think they can do better, and why not?

Doubtless young people of the South were moving to the West and North for the same reason that those of Canada, New England and the Middle states were moving there, viz: to occupy and grow up with new states and cities. During this time capital also was flowing from the Middle and Eastern states, and from Europe, to develop the new regions, open mines, provide railroads, public buildings and other public utilities—all resulting in a distribution of employment and wages. Some of these "absentee" investments were profit-

able, but many were not. The late Thomas B. Reed, of Maine, visited Seattle after the panic of 1893, and they gave him a "welcome" dinner. In his response he said, rather ruefully, "We have sent you our children and our money, and none have ever come back!"

Incidentally, it may be added that the youth of the North, East and West as well as of the South, have been moving from farms to cities, for two very good reasons, viz: (1) The market demand for farm products, and particularly food, does not keep pace with the aggregate demand for all manufactures and services; (2) the birth rate on farms is higher than in the cities. The two tendencies go far toward explaining the low average of farm-incomes, both North and South. Of course, if more persons are born on farms than are needed there, and too many stay regardless of pay, the pay is sure to be proportionately low. It follows that the more agitation there is for keeping people on the farms who are not needed there, and the more the Government does to keep them there, the greater the depression in agriculture will be.

The Need for Capital

Obviously the South needs a greater diversification of industry. A shift of workers from farms to factories would improve conditions on the farms and enable the remaining farmers to buy more factory goods. Factories require machinery and bank balances, for which the general term is "capital," meaning a saved-up product of Labor which may be used to aid Labor in production for common use. There could be no more striking illustration of the part played by capital in social welfare than is afforded by the comparisons of the second paragraph of the first quotation above.

It is true that the South has the wealth of natural resources named, and that it has had serious handicaps; but it also has splendid industries, which, in much the greater part, have been built up and are owned by its own people. It needs nothing so much as more of them. It should be obvious that the standard of living of any people is dependent upon its facilities for production.

In view of the known problems faced by the South in the years following the civil war, it need not be thought strange that the old South did not keep full pace in economic development with the North and the West. It is hardly fair to array and emphasize its deficiencies, without telling more of what the new South has accomplished. As an example, not only of what has been done, but of the means by which it was done, we quote the following from section 14 of this Report:

> With respect to the manufacture of cotton textiles, the South has come from a subordinate position in 1860 to a dominating position today. It is natural that the South's most outstanding accomplishment in industry should be the processing of its greatest agricultural crop. The cotton manufacturing industry started in the latter part of the nineteenth century with small subscriptions of stock, provided for the most part by Southerners; but when these mills began to compete successfully with the New England mills, Northern capital was introduced, and later a great many Northern mills were shifted to the South.

James W. Cannon, of North Carolina, was a farm boy who saved a little money and started a country store, and later a small cotton mill. The profits of the mill were put back into the business, and the great Cannon Mills Company of Kannapolis, N. C., with 17,000 employes, is the outstanding result. Ellison E. Smyth, of South Carolina, one of the leading figures in the development of the industry, made an equally small beginning, except that he had a larger and older city to help, viz: Charleston. Fuller E. Callaway, of Georgia, was a country storekeeper who passed around a subscription paper to raise capital for a small cotton mill and later built up a large group of successful enterprises. Hundreds of Southern industries have a like background.

The Report might have given actual figures from the 1938 "Blue Book of Southern Progress," an annual publication issued by the "Manufacturers Record," a well-known Baltimore publication, devoted to Southern development. We quote from the "Blue Book" as follows:

> Eighty-seven per cent of the cotton used in all American mills is consumed in the South by textile establishments. Since 1922 this territory has shown an increase of 2,500,000 spindles, which now have reached the total of 18,913,455. The rest of the country's reported installed spindles total 8,069,000. * * * The decline of installed cotton spindles which has been taking place in the United States since 1925, has been confined almost entirely to the New England states, where the loss to date aggregates 10,946,000. Southern mills consumed 6,647,000 bales of American cotton in 1937 and 89,306 bales of foreign cotton.

The same authority comments upon another branch of the textile industry as follows:

> The greatest textile advance in the South in recent years has been in knitting mills and rayon manufacturing. As of the 1935 census, the South had 359 knitting establishments which produced $147,647,000 of goods and spent $73,552,000 for materials and power. With 70 per cent of the rayon capacity of the country, the South in 1935 produced $104,000,000 of rayon yarn, 56 per cent of the domestic output. Since 1935 several new mills have been erected and gone into operation.

We quote further, upon general progress in manufacturing:

> In manufacturing, the value of output last year in the South reached the enormous total of approximately $10,500,000,000. More than $223,000,000 was invested in new industrial plants. The value of manufactured products in the year 1935, which is the latest year for which comparable figures are available, was $8,632,-000,000. The increase was nearly $2,000,000,000 or almost 25 per cent.
>
> These reports, on which the 1935 census was based, came from 34,143 manufacturing establishments which paid out $1¼ billion in wages to 1⅛ million employees, and also paid out $5,411,000,000 for the materials, fuel and purchased power used in their manufacturing processes.

The Report made public by the National Emergency Council refers briefly to the manu-

facture of cottonseed products, which it says reached a value in 1929 of $265,247,000; but confines its references to tobacco, iron and coal to two comments, viz: "The manufacture of cigarettes has become important in Virginia and North Carolina" and "The iron and steel industries are important in Alabama." The Blue Book says that the value of cigarettes and other manufactured tobaccos sold in 1937 was $697,-623,415, that iron ore mined aggregated 4,217,-859 tons in 1936 and 6,414,000 tons in 1937, and that 47 per cent of the bituminous coal mined in this country in 1937 came from the South.

The Council Report did better by the forest products industries, of which it says:

The use of the Southern forests for many purposes has constantly grown. In January, 1938, the South had thirty-eight pulp mills built or being built, with a total investment estimated at some $200,000,000. Many new uses have been found for this pulp, such as the manufacture of building boards, rayon staple fiber, wrapping paper, and quite recently newsprint paper. As the United States is the largest consumer of wood pulp in the world, the development of this industry in the South is significant.

The "Blue Book" backs this up as follows:

The rapid development that has come about in the manufacture of pulp and paper from Southern pine has created a source of income of great value to the farmer. Pine of a size necessary for the purpose can be grown [from seedlings] in ten years or less, and the mills located in various states, while owning large timber acreages, afford a ready market for pine timber at paying prices to farmers over a wide area.

More than $100,000,000 has been invested in the last two years in mills to use pine wood for the manufacture of paper and pulp.

Mills are under way for the manufacture of newsprint, which through Dr. Charles H. Herty's indefatigable labor is equal to any newsprint now manufactured. The utilization of the South's resources to supply the publishers of America, who now buy from $175,000,000 to $200,000,000 worth of wood pulp from foreign countries, will keep this market at home, adding to the wealth of our citizens and the employment of labor. This is only one phase of what chemistry is doing in the South.

Dr. Charles H. Herty, distinguished son of Georgia, whose name will live in the annals of the State as one of its great benefactors, passed from his labors shortly before this final report was published (July 27, 1938).

New Paper and Pulp Industries

We are indebted to Mr. S. A. Lauver, of the Manufacturers Record, for more detailed data regarding the $100,000,000 recently invested in pulp and paper mills from Virginia to Texas. Without giving figures for each, they are named below, in the alphabetical order of the States in which they are located:

Arkansas—at Crossett: Crossett Paper Mills, an affiliate of Crossett Lumber Company, Davenport, Iowa.

Florida—at Fernandina; pulp mill, built by Kraft Corporation of America, since merged with Container Corporation of America. Offices in Chicago; also the Fernandina Pulp & Paper Co.; the St. Joe Paper Co. of St. Joe, one-half owned by the Mead Corporation, Chillicothe, Ohio, and one-half by the National Container Co., of Jacksonville.

Georgia—at Savannah: Union Bag & Paper Company, headquarters, New York; a merger of numerous early companies, with plants in several states. This plant may have been a direct result of Dr. Herty's experiments in a State laboratory in Savannah. The product will be wrapping and bag paper. Aggregate cost will be about $12,000,000, and is being financed partly by sale of serial notes of the Union Bag and Paper Co.

Louisiana—at Spring Hill, near Arkansas line. Plant of Southern Kraft Corporation, wholly owned subsidiary of the International Paper Company of Boston, which has properties in several states and Canada. Southern Kraft was organized in 1930, and has been a pioneer in the manufacture of wrapping paper from Southern pine. To the end of 1937 it had built or acquired seven paper mills in the South, which produced last year 662,262 tons of pulp. The Spring Hill Mill has been opened in 1938, and is the eighth of the Kraft group. A financial news item early last month said: "The Southern Kraft Corporation increased its 6 per cent notes by $200,000 in July, making $9,400,000 outstanding at the close of the month. The notes were issued to International Paper Company and pledged with banks which advanced funds for capital expenditures in connection with construction of Southern Kraft's new mills."

North Carolina—at Plymouth. Kieckhefer Container Corporation, cost about $7,000,000; also proposed plant of Riegel Paper Corporation near Wilmington, estimated at about the same investment.

South Carolina—at Georgetown, on seaboard. Southern Kraft Corporation (International Paper Co.,again); also a new plant at Charleston, the old South Atlantic port, built by West Virginia Pulp & Paper Corporation, with headquarters in New York.

Texas—at Houston; $5,000,000 plant of Champion Paper Company of Hamilton, Ohio, which already had a plant in Canton, North Carolina. Perhaps the most outstanding Texas project is the one at Lufkin, backed by a group of Southern newspapers, which will be the first plant built to manufacture newsprint from Southern pine. Contract is by the Southland Paper Mills, Inc., as announced by the Manufacturers Record.

Virginia—A new paper plant of the Chesapeake-Camp Corp. (owned by Albemarle-Chesapeake Co., Inc.) at Franklyn has cost $5,000,000.

Other Industries

Above comprises paper plants recently built or contracted, although Hollingsworth & Whitney have proposed a large plant for Mobile.

As to other industrial developments, the Aluminum Ore Co., a subsidiary of the Aluminum Company of America, is completing a $4,000,000 plant at Mobile. The National Gypsum Co. of Buffalo, N. Y., has recently completed a new fibre board plant in Mobile, and these facilities are to be augmented by a $1,000,000 plant in the Port Wentworth industrial area of Savannah, Georgia. Another Mobile project is that of the Meyercord Compound Lumber Company, a subsidiary of a Chicago concern. The Alabama Power Company has expended $1,700,000 to construct a 137 mile power-line to the port of Mobile.

The Texas Company is understood to have a project for constructing 250 miles of pipe from Louisiana oil fields to its refinery at Port Arthur, Texas. Cost of this enterprise is estimated between $2,000,000 and $2,500,-000. American Cyanamid & Chemical Corporation will build at both Savannah and Mobile. Johns-Manville Corporation is now building a $1,000,000 plant at Jarratt, Virginia. American Viscose Company is now completing its huge Front Royal, Va., plant. Southern Alkali Corporation's new Corpus Christi, Texas, plant will cost $1,000,000.

The Southern states as a rule have recognized the advantage of pushing industrialization and notable in this respect is Louisiana. Under the guidance of Governor Richard Leche, this State, by its tax exemption policy, has obtained a number of new industries, or expansion of existing plants. DuPont's ethyl gasoline plant at Baton Rouge is costing $13,500,000; Solvay Process Company's plant, $1,000,000; Skelly Petroleum refinery, $800,000; Mathieson Alkali Works, $815,000; Standard Oil Company, $7,000,000. In Mississippi, a similar program is being pressed, the most important result to date being a $1,000,000 plant for the Armstrong Tire and Rubber Company at Natchez. It is my understanding that these tires will be for mail order distribution.

The Monsanto Chemical Company (St. Louis) has made a heavy investment in Maury County, Tennessee, for its phosphorus plant. A similar plant for the Victor

Chemical Works, of Chicago, will cost $1,000,000, and be located near Columbia, Tennessee. Electrometallurgical Company's plant project for northern Alabama will cost about $5,000,000 when completed.

Steel expansion is promising in the South. The "Pittsburgh Plus" system of price-making, of which the South has complained, having been abandoned, Birmingham ranks with Pittsburgh and Chicago as a basing point. The Tennessee Coal, Iron and Railroad Company, subsidiary of United States Steel Corporation, at Birmingham, has spent more than $30,000,000 for expanding its facilities. At Baltimore, the South's northern-most city, the Bethlehem Steel Corporation has lately expended $35,000,000 for additional facilities. National Steel will make an outlay of $5,000,000 at Weirton, in West Virginia, to widen the range of products of the Weirton Steel Company.

Obviously this is a review of only the more important new enterprises in the South. It is a more heartening statement than that offered by the National Emergency Council.

Mr. Ernest E. Norris, President of the Southern Railway Company, in an interview last month was quoted as saying:

> We have great hopes that the cigarette paper plant now building in North Carolina will mark the introduction of a new industry in the United States and the development of a new crop for the Southern States. Cigarette paper now comes exclusively from France and is derived from flax. The plant in our territory, when completed, initially will use flax grown in Minnesota and California, but we hope that flax will be grown on a good scale in the South when the new industry takes hold. The plant on the Davidson River will have sufficient capacity to take care of about one-third of the domestic cigarette paper consumption.

What Remedies Are Proposed?

No doubt the signers of the Emergency Report would agree that the fundamental need of the South is for more capital. Every section of the Report stresses needs that can be satisfied only by the use of capital in ways that will provide employment and increase the supply of common comforts. Unfortunately, the Report is not clear as to policies. The only way to attain both ends is by producing goods that satisfy wants, and at prices within the purchasing power of the people. It is impossible to increase purchasing power by raising costs and prices, for that depletes purchasing power and causes unemployment. Every one of the new industrial plants listed above has been built to cheapen costs by improved methods, and to provide permanent employment with lower prices for the products than have prevailed heretofore.

In opposition to this policy, this Report adopts the theory that improved methods and machinery make for unemployment. It says:

> In certain sections there has been a tendency to revert to large plantations worked by machinery on an industrial basis. Tractors and gang plows are substituted for men and mules. This method of cutting operation costs also cuts the number of people needed for a given area of land or amount of crop.

If this is sound thinking, why not scrap all machinery (including all modern transportation systems and agricultural equipment), and go back to the primitive conditions when men gave four years of life to pay their passage to America?

Again, many of the new enterprises named above are being carried forward by means of "absentee" capital, which is listed as one of the causes of the South's distress. The Report says:

> The large absentee ownership of the South's natural resources and the South's industry makes it possible for residents elsewhere to influence greatly the manner in which the South is developed and to subordinate that development to other interests outside the South.

The ownership of corporations whose securities or stocks are listed on the public exchanges may be anywhere. Anyone may buy them and they are bought and sold continually all over this and foreign countries. But, wherever the ownership may be distributed, it is certain that the payrolls will be located in the South, and this is the factor of chief importance. The United States Treasury reports show that in the eight years 1922-1929, (the best eight years in the history of American industry) more than 95 per cent of the aggregate gross income of the manufacturing industries of the United States was paid out for operating expenses, and that a substantial portion of the remaining 5 per cent was used for the enlargement of productive capacity.

The friends of Dr. Herty will be sure to reflect upon what his comments upon this Report would have been, for he confidently predicted an influx of capital into the paper industry of the South, and that it would be welcomed by every locality chosen. This prediction has been verified by the action of the State of Louisiana referred to above, and by reports from every locality where a new industry is proposed. Indeed, the Council report deplores the competitive zeal of Southern communities in seeking industries.

The Council Report was prepared, of course, in a spirit of loyalty and devotion to the South, but it is addressed to the entire country, and, if discussed frankly, temperately and intelligently, great good may result. Among the most valuable lessons that may be learned from it are — (1) that productive capital is indispensable to economic progress; (2) that an increasing supply benefits every member of the community, whether he owns any or not; and (3) that the surest way for any country or region to obtain more of it is by bidding it welcome and permitting it to grow.

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